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Controller Finds Pension Spiking Vulnerabilities at CalPERS

Passive Oversight and Underutilization of Automation Create Risk

SACRAMENTO – State Controller John Chiang today released a report on efforts made by the California Public Employees' Retirement System (CalPERS) to detect and prevent pension spiking practices at the 3,100 public agencies which contract with the system. The report found CalPERS's failure to use automated controls and more proactively review payroll data exposes the system to the manipulation of pay for the purpose of "spiking" retirement benefits. Also, the review found that CalPERS lacks sufficient audit capacity to cover all the State and local governments with which it contracts. On the current audit schedule, a local government that contracts with CalPERS, for example, would only face an audit once in every 66 years.

"The good news is that my office sampled 11 employers within the CalPERS system and found no incidences of pension spiking," said Chiang. "The discouraging news is CalPERS's lack of robust auditing, underutilization of advanced technology, and its generally passive approach to the problem invites abuse. The State's largest pension system can and must be more vigorous in protecting taxpayers from this form of public theft."

The review focused on audit oversight and internal controls at CalPERS aimed at identifying, preventing and eliminating pension spiking. The Controller also reviewed 11 CalPERS member agencies -- three state agencies, two counties, two cities, and four special districts -- to determine if any retirements occurring during the audit span included any inappropriate benefit enhancements.

Those 11 member agencies included a geographically-diverse sample of public entities that included the California Department of Fish and Wildlife, the California State University Chancellor's Office, the County of Riverside, CalPERS, the County of Placer, the City of Oakland, the City of Colton, the Grossmont Healthcare District, the Inverness Public Utility District, the Metropolitan Water District of Southern California, and the Woodside Fire Protection District.

Although the Controller's review of the 11 reporting entities did not identify an incident where a retiring employee received an inappropriate pension enhancement, it did discover that CalPERS doesn't regularly run the monthly payroll data it received through automated controls to identify indicators of pension spiking.

At CalPERS, the Controller found that the pension fund has developed a number of electronic risk assessment tools that can be used to detect pension spiking, but does not effectively use them. Instead of applying these automated data mining tools to all payroll data received from its member agencies on a monthly basis to identify anomalies indicative of abuse, CalPERS only performs a risk assessment once per year and the primary driver of that assessment is whether that agency has employees compensated at greater than $245,000 per year.

Compounding the deficiencies inherent in an approach that does not systemically screen data on a frequent basis, CalPERS generally only reviews pay data for spiking when an employee of a member agency is about to retire. This lack of up-front, real-time accuracy verification needlessly creates opportunities for abuse to occur.

CalPERS has insufficient auditing resources to effectively oversee its more than 3,000 member agencies. Available resources limit its annual reviews to only 45 (or 1.5%) of its membership. At this rate, a public agency would only face a pension spiking audit once every 66 years. Since the audit was completed, CalPERS has added additional staff; however, with the change, it still would be once every 33 years that an agency would face an audit.

The Controller's Office strongly recommends CalPERS address the understaffing immediately, makes full use of its electronic tools, and deploy a more rigorous and prevention-based approach to combating pension spiking.

Finally, the review observed a form of "legal" pension spiking authorized with the 1993 enactment of California Government Code section 20692. This method of pension enhancement involves a one-time shift in "pick-up" payments, or payments made by employers to cover the employee's share of pension costs.

Commonly referred to as "Employer Paid Member Contributions," 97 contracting agencies -- primarily local governments and special districts -- have contract amendments allowing them to withdraw the commitment to pick-up the retirement contribution in the employee’s final year, and will instead add the cash value of that payment to the employee's salary to be paid by the employee as a retirement payment.

While this arrangement does not affect the total cash value being sent to the pension fund each year, it does "spike" the employee’s final year of compensation by shifting the cash value of the pension payment into the regular salary. As a result of the California Public Employees’ Pension Reform Act of 2013, this optional benefit is no longer available to new members. However, the Controller’s review concluded that the contract amendments increased members pay by $39.1 million in annual pensionable compensation for participating employees. This arrangement could provide as much as $796 million in this type of pensionable compensation over 20 years.

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